



**STATE BOARD OF EQUALIZATION  
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date:	02/18/14	Bill No:	<a href="#">Assembly Bill 1785</a>
Tax Program:	Cigarette and Tobacco Products	Author:	Garcia
Sponsor:	Author	Sections:	RTC 30165.1
Related Bills:		Effective:	01/01/15

**BILL SUMMARY**

This measure:

- Allows the Board of Equalization (BOE) to disclose to the Attorney General any Cigarette and Tobacco Products Tax Law (CTPTL) information necessary to determine compliance with the Master Settlement Agreement (MSA); and
- Authorizes the Attorney General to share that CTPTL information with any data clearinghouse or other entity performing duties related to the MSA.

**ANALYSIS**

**CURRENT LAW**

**Cigarette and Tobacco Products Tax Law<sup>1</sup> (CTPTL).** Revenue and Taxation Code (RTC) Section 30451 specifically provides that the BOE shall enforce the provisions of the CTPTL and may prescribe, adopt, and enforce rules and regulations relating to its administration and enforcement.

Existing law imposes an 87 cent per package of 20 (43 ½ mills per cigarette) cigarette tax. The CTPTL requires tax payment through the use of stamps or meter impressions that a distributor affixes on each cigarette package prior to the distribution.

The BOE annually determines the tobacco products tax based on the March 1 cigarette wholesale cost. The fiscal year 2013-14 surcharge rate is 29.82%. Distributors pay the tobacco products tax based on their tax return that reports the wholesale cost of the tobacco products distributed and calculates the tax due.

**Face-to-Face Sale.** RTC Section 30101.7 prohibits a person from making a delivery sale of tobacco products, excluding cigars and pipe tobacco, to a California consumer unless the delivery seller: (1) fully complies with the Federal Jenkins Act,<sup>2</sup> (2) obtains and maintains a Cigarette and Tobacco Products Licensing Act (Licensing Act) license, (3) complies with the Model Statute,<sup>3</sup> and (4) reports its delivery sales to the Attorney General. A “delivery sale” means the sale of cigarettes or tobacco products into and in this state in either of the following cases:

- The consumer submits the sales order by telephone or other voice transmission method, the mail, or the Internet or other online service, or the seller is otherwise

<sup>1</sup> Part 13 commencing with Section 30001) of Division 2 of the Revenue and Taxation Code.

<sup>2</sup> Chapter 10A of Title 15 of the United States Code.

<sup>3</sup> Article 3 (commencing with Section 104555), Chapter 1, Part 3, Division 103 of the Health and Safety Code.

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not in the physical presence of the consumer when the request for purchase or order is made.

- A common carrier, private delivery service, or other method of remote delivery delivers the cigarettes and tobacco products to the consumer, or the seller is not in the physical presence of the consumer when the consumer obtains possession of the cigarettes or tobacco products.

Section 30101.7 authorizes the BOE to provide to the Attorney General information relative to a seller's failure or attempt to comply with the Federal Jenkins Act, as amended by the Prevent All Cigarette Trafficking Act (PACT Act). The section requires the BOE to enforce **only** the licensing and tax provisions.

*Tobacco Directory Law.* Also incorporated in the CTPTL is the **Tobacco Directory Law**, which more effectively enforces and promotes the purpose of the Model Statute. The Tobacco Directory Law, which can be found in Section 30165.1, requires, in part, the Attorney General to develop and publish on its Internet web site a directory listing the following:

- All tobacco manufacturers that have provided current, timely, and accurate certifications that certify the tobacco manufacturer is either a participating manufacturer (PM) that has made all MSA payments, as described, or is a non-participating manufacturer (NPM) that has made all required escrow payments.
- All brand families that are listed in the certifications, except as specified.

No person may affix, or cause to be affixed, any tax stamp or meter impression to a package of cigarettes, or pay the tax levied on a tobacco product defined under Section 30165.1 as a cigarette, unless the brand family of cigarettes or tobacco product, and the tobacco product manufacturer that makes or sells the cigarettes or tobacco product, are included on a compliance list posted by the Attorney General.

The Tobacco Directory Law also prohibits a person from:

- Selling, offering, or possessing for sale in this state, shipping or otherwise distributing into or within this state or importing for personal consumption in this state, cigarettes of a tobacco product manufacturer or brand family not included in the Attorney General's directory, and
- Selling, distributing, acquiring, holding, owning, possessing, transporting, importing, or causing to be imported cigarettes that the person knows or should know are intended to be distributed in violation of the Tobacco Directory's stamping prohibitions or are not included in the Attorney General's directory.

The Tobacco Directory authorizes the BOE to disclose to the Attorney General any information received under the CTPTL for purposes of determining compliance and enforcing specified CTPTL sections,<sup>4</sup> the Model Statute, and any related regulations.

**Federal Jenkins Act.** The Jenkins Act requires any person that sells, transfers, or ships cigarettes or smokeless tobacco<sup>5</sup> for profit in interstate commerce and ships those products into a state that imposes a tax on them to:

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<sup>4</sup> RTC Sections 30101.7, 30165.1 and 30165.2.

<sup>5</sup> Operative July 1, 2010, the Jenkins Act was amended by S. 1147, known as the Prevent All Cigarette Trafficking Act. It expanded the Jenkins Act to include smokeless tobacco and incorporated "delivery seller" provisions.

- File with the Attorney General and the state's tobacco tax administrator a statement setting forth certain information, including name, address and telephone number; and
- Not later than the 10th of each calendar month, file with the tobacco tax administrator a memorandum or a copy of the invoice for each and every shipment of cigarettes or smokeless tobacco made during the previous calendar month in that state. This information is required to show, among other things, the name and address of the person to whom the shipment was made, the brand, and quantity of the shipment.

The Jenkins Act also requires each delivery seller to comply with specified shipping and recordkeeping requirements,<sup>6</sup> and all state, local, tribal, and other laws as if the delivery sales occurred entirely within the state, including the related tax collection requirements. A delivery seller is defined as any person who makes a sale of cigarettes or smokeless tobacco to a consumer if: (1) the consumer submits the order by telephone or other method of voice transmission, mail, Internet or other online service, or the seller is otherwise not in the physical presence of the buyer when the request for purchase is made, and (2) the cigarettes or smokeless tobacco are delivered to the buyer by common carrier, private delivery service, or other method of remote delivery, or the seller is not in the physical presence of the buyer when the buyer obtains possession of the cigarettes or smokeless tobacco.

Operative July 1, 2010, the Jenkins Act was amended by S. 1147, known as the Prevent All Cigarette Trafficking Act or PACT Act. It expanded the Jenkins Act to include smokeless tobacco and incorporated "delivery seller" provisions, which among other things, require delivery sellers to comply with the state's laws imposing excise taxes, licensing, and stamping requirements.

#### **PROPOSED LAW**

This bill amends RTC Section 30165.1 to:

- Allow the BOE to disclose to the Attorney General any information received pursuant to the CTPTL for purposes of determining compliance with and enforcing the MSA;
- Authorize the Attorney General to share that information with any data clearinghouse or other entity performing duties related to the MSA; and
- Require the information shared only for the purpose of determining compliance with and enforcement of Sections 30165.1 (Tobacco Directory), 30101.7 (face-to-face sales) and 30165.2 (Federal returns and reports), the Model Statute, and any related regulations promulgated, or corresponding law of other states, and the MSA.

The bill becomes effective January 1, 2015.

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<sup>6</sup> Labeling requirements, weight restrictions, and age verification.

### IN GENERAL

Phillip Morris USA Inc., R.J. Reynolds Tobacco Company, the Lorillard Tobacco Company, and fourteen smaller companies alleged that California and other States failed to “diligently enforce” state laws requiring NPMs to pay money into escrow for every cigarette sold in the state. As a result, the PMs withheld more than \$723 million from their 2003 MSA payments in a disputed payments account pending the outcome of the arbitration.

The arbitration panel found that Colorado, Illinois, Iowa, Maine, Ohio, Oregon, New York, North Dakota, and Washington diligently enforced their escrow laws. Six states (Indiana, Kentucky, Maryland, Missouri, New Mexico, and Pennsylvania) were found not to have diligently enforced the settlement.

A settlement agreement was reached with 22 other states, including California, the District of Columbia, and Puerto Rico, each on its own terms. As a result, California received over \$373 million in April 2013 and \$2.3 million in October 2013. In addition, the settling states signed on to a settlement “[Term Sheet](#)” offered by the PMs. The settlement addresses claims relating to a downward adjustment to the annual MSA payment obligations known as the NPM Adjustment. The settlement resolves disputes that relate to 2003 through 2012 payments, and puts in place a new method to determine future adjustments from 2013 forward.

Generally speaking, the agreement sets forth a sliding scale of financial recovery for PMs that depends on the level of state participation. To become effective, the Term Sheet must be reviewed and approved by the Arbitration Panel that is currently in place to deal with the 2003 NPM Adjustment (and other NPM Adjustment-related matters). The parties, including the California Attorney General, will cooperate in the drafting and execution of a comprehensive final settlement agreement incorporating the provisions of the Term Sheet.

### BACKGROUND

Under the November 1998 MSA between California, other states, and tobacco product manufacturers, each tobacco company must make annual payments to the participating states in perpetuity, totaling an estimated \$206 billion through 2025. California's share of the revenue was projected to be \$25 billion, based on receiving approximately 12.8% of the total payments. The payments are split 50/50 between state and local governments under a Memorandum of Understanding negotiated by the Attorney General and various cities and counties which also sued the tobacco companies. Through October 2013, California has received approximately \$12 billion in [payments](#) that are divided between the state and local governments.

The payment provisions of the MSA apply to “participating manufacturers” that include both original signatories to the MSA, as well as other companies that subsequently agree to be bound by the MSA. In return for these payments, the states have agreed to release the cigarette manufacturers from all claims for damages, penalties, and fines. In addition, the PMs have agreed to certain non-economic terms that restrict their advertising and marketing practices and control their corporate behavior. The primary purpose of these restrictions is to prevent marketing of cigarettes to minors and thereby reduce smoking by minors.

The MSA prompted states to enact the Model Statute by creating a significant financial incentive: Settling States that enact and “diligently enforce” the Model Statute are not subject to severe reductions to their MSA payments. All Settling States, including

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California, have enacted Model Statutes requiring NPM reserve (escrow) funds. California's "Model Statute" was enacted in 1999 pursuant to Senate Bill 822 (Escutia, Chapter 780). That bill, among other things, authorized the BOE to adopt any regulations necessary to ascertain, based on the amount of state excise tax paid on cigarettes, the number of tax paid cigarettes sold by tobacco products manufacturers who do not participate in the MSA.

While the Settling States, such as California, have aggressively enforced the Model Statutes, enforcement has proved costly and cumbersome. Accordingly, almost every state has enacted Complementary Legislation to more effectively enforce the Model Statutes and support their original purpose.

In 2003, California enacted Complementary Legislation (Tobacco Directory Law) pursuant to Assembly Bill 71 (Horton, Chapter 890). Generally, these statutes:

- Require the Attorney General to develop and publish on its Internet web site a directory of all tobacco manufacturers that have provided current, timely, and accurate certifications that certify the tobacco manufacturer is either a PM under the MSA, or is a NPM that has made all required escrow payments, and all brand families that are listed in the certifications, except as specified.
- Prohibit a person from affixing, or causing to be affixed, any tax stamp or meter impression to a package of cigarettes, or from paying the tax levied on a tobacco product defined as a cigarette, unless the brand family of cigarettes or tobacco product, and the tobacco product manufacturer that makes or sells the cigarettes or tobacco product, are included on a compliance list posted by the Attorney General.
- Subject violators, principally manufacturers and distributors, to civil and criminal penalties and license suspension or revocation.

In 2010, Assembly Bill 2494 (Nava, Chapter 265) made numerous amendments to RTC Section 30165.1's Tobacco Directory Law. That bill was sponsored by the Attorney General and intended to, in part, strengthen the Attorney General's and BOE's ability to diligently enforce the Model Statute and Tobacco Directory Law. Among other things, that bill (1) expanded the prohibition for any person selling, offering, or possessing for sale in this state or import for personal consumption in this state, to also include shipping or otherwise distributing into or within this state, cigarettes of a tobacco product manufacturer or brand family not included in the Tobacco Directory; (2) expanded from a distributor to any person the imposition of penalties for violating the Tobacco Directory Law; and (3) provided specified limits on notification and removal of cigarettes from the Tobacco Directory. The bill also required a foreign tobacco product manufacturer whose cigarettes are imported into the United States to submit to the Attorney General and the BOE:

- Each and every applicable return, form, or report filed with the Alcohol and Tobacco Tax Trade Bureau and the United States Customs and Border Patrol that includes any information about cigarettes of that foreign tobacco product manufacturer imported into the United States, and
- A report of the sales of each brand family in this state, as specified.

**COMMENTS**

1. **Sponsor and purpose.** This measure is sponsored by the author and is intended to permit the Attorney General to disclose confidential taxpayer information with a data clearinghouse or other entity performing MSA duties. According to the author, the information shared will be limited to MSA compliance purposes and will allow California to meet its obligations under the 2012 settlement, which protects its future MSA settlement payments.
2. **What CTPTL information does the BOE receive?** The CTPTL requires cigarette and tobacco product distributors and wholesalers to be licensed. Additionally, the law requires cigarette and tobacco product manufacturers and importers to register with the BOE.

The BOE receives information from all licensed distributors, wholesalers, manufacturers, and importers. Existing law requires these licensees to file tax returns, reports, or schedules with the BOE. If a consumer purchases cigarettes or tobacco products for their own use from outside the state without paying California excise tax, the CTPTL also requires the consumer to report and pay the tax directly to the BOE. Consumers must likewise report and pay the tax if they physically bring any quantity of tobacco products or more than 400 cigarettes into California.

Examples of reports, schedules, and other information received by the BOE under the CTPTL includes, but is not limited to: [Cigarette Distributor's Application for Deferred Payment Option](#), [Schedule of Cigarette Brand Family Names](#), [Schedule of Tobacco Products Brand Family Names](#), [Cigarette Distributor's Tax Report](#), [Cigarette and Tobacco Products Excise Tax Return](#), [Cigarette Manufacturer's Tax Return of Taxable Distributions in California](#), [Tobacco Products Distributor Tax Return](#), [Tobacco Schedule T](#),<sup>7</sup> [Cigarette Wholesaler's Return](#), [Cigarette Tax Disbursement Schedule](#), [Cigarette Tax Receipt Schedule](#), [Common Carrier's Report of Cigarette Deliveries](#).

Existing CTPTL also provides the BOE the authority to require additional information from licensed distributors, dealers, transporters, common and private carriers, warehousemen, bailees, and other persons.

The CTPTL already authorizes the BOE to disclose to the Attorney General any and all information specified above and any other information the BOE receives pursuant to the CTPTL for Tobacco Directory, Model Statute, and face-to-face sale enforcement purposes. This measure expands the information sharing for MSA enforcement and also authorizes the Attorney General to share the information with any data clearinghouse or other entity performing duties related to the MSA.

3. **BOE confidentiality procedures and requirements.** The BOE must collect information in order to administer its more than 20 tax and fee programs. The BOE uses the information to determine tax and fee law compliance, including tax and fee payment/collection. These records are covered by state laws that protect [privacy](#). The existing law also authorizes the BOE to share account information with specified state, local, and federal government agencies.

With respect to the CTPTL, Section 30455 makes it “unlawful for the BOE or any person having an administrative duty under this part to make known in any manner whatever the business affairs, operations, or information obtained by an

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<sup>7</sup> Cigarettes and roll-your-own tobacco sold in California and made by nonparticipating manufacturers.

investigation of records and equipment of any person visited or examined in the discharge of official duty, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any report, or to permit any report or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person.” The CTPTL allows the BOE to exchange with other state officials information concerning interstate cigarette and tobacco products shipments. Also, as previously stated, RTC Section 30165.1 authorizes the BOE to disclose to the Attorney General any CTPTL information received for Tobacco Directory, face-to-face sales, and the Model Statute enforcement.

4. **What is a data clearinghouse?** BOE staff understands a data clearinghouse to be a private entity assigned certain duties pursuant to a contract between the Term Sheet states and the PMs. It appears that the data clearinghouse will use the CTPTL information to make necessary calculations and determinations to ascertain the amount, if any, of each Term Sheet state’s NPM adjustment for certain paid sales. However, the precise data clearinghouse duties and distributor data uses are undefined and are the subject of negotiations between Term Sheet states and PMs. It is also not clear how the data clearinghouse will protect and secure the taxpayer information.
5. **What is the BOE’s enforcement role for the Model Statute?** The BOE has several responsibilities with respect to “diligent enforcement” of the Model Statute, which protects the state’s approximately \$1 billion annual MSA revenue stream. The BOE’s enforcement role under the various MSA-related statutes, which coincides with administration of the CTPTL, is as follows:

- **Model Statute:** Requires NPMs to place into a qualified escrow fund by every April 15 an amount, as specified, based on units sold during the previous year. “Units sold” is generally defined to mean the number of individual cigarettes sold to a consumer in the state by the applicable tobacco product manufacturer, whether directly or through a distributor, retailer, or similar intermediary or intermediaries, during the year in question, regardless of whether the state excise tax was due or collected.

Under this provision, the BOE provides the Attorney General with annual statistics of cigarettes sold in California by NPMs. The BOE compiles this information measured by the excise tax reported to the BOE, which is adjusted by BOE staff to remove brands that are considered a “cigarette” for tax purposes, but not for purposes of the Model Statute.

- **Tobacco Directory Law:** Prohibits a distributor from affixing a tax stamp to a package of cigarettes, or paying the tax on a tobacco product defined as a cigarette, unless the brand family of cigarettes or tobacco product, and the tobacco product manufacturer that makes or sells the cigarettes or tobacco product, are included on the Tobacco Directory<sup>8</sup>. A violation of this prohibition could result in the revocation or suspension of the license or licenses of the distributor and/or a civil penalty and subject such products to seizure and forfeiture by the BOE.

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<sup>8</sup> Tobacco products commonly known as “little cigars” currently do not have to be listed in the tobacco directory in order to be lawfully sold in California. The AG may decide in the future to require that certain brands of little cigars be listed in this Directory.



- **Licensing Act:** Requires every manufacturer or importer to obtain and maintain a license to engage in the sale of cigarettes. In order to be eligible to obtain and maintain a license, a manufacturer or importer that is a “tobacco products manufacturer” pursuant to the Model Statute must (1) certify to the BOE that it is a “participating manufacturer” or is in compliance with the Model Statute, and (2) submit to the BOE a list of all its brand families. AB 71 also gave the authority to the BOE to revoke or suspend a distributor’s license for selling a product not listed in the Tobacco Directory.
  - **Other CTPTL:** Allows a BOE employee, upon presentation of the appropriate identification and credentials, to enter into, and conduct an inspection of, any building, facility, site, or place if there is evidence of noncompliance with the Model Statute or the Tobacco Directory Law. The CTPTL also authorizes the BOE to seize cigarettes or tobacco products to which a tax stamp is affixed, or tax paid, in violation of the Tobacco Directory Law.
6. **BOE workload and funding.** This measure results in unknown BOE workload impact until the Term Sheet states and PMs reach an agreement that defines the CTPTL information to disclose and the disclosure format. The BOE may require significant resources to comply with the Term Sheet agreement. For example, the resulting Term Sheet agreement may mandate distributors, wholesalers, manufacturers and/or importers to submit additional information. Such a mandate requires the BOE to develop forms, update publications and program computers. The agreement may also require the BOE to collect and summarize years of relevant MSA information to share with the Attorney General; require the BOE to electronically transmit the information that requires additional computer programming; or require BOE staff to reproduce and transmit years of prior tax returns and reports.

As stated previously, the BOE has several MSA and related statute enforcement responsibilities. Each CTPTL responsibility tasked to the BOE takes time and resources paid from the cigarette and tobacco products funds (prorated based tax deposits): General Fund, Breast Cancer Fund, Cigarette and Tobacco Products Surtax Fund (Proposition 99), and the California Children and Families Trust Fund (Proposition 10). Should the cigarette and tobacco products funds support enforcement of the MSA and related statutes? BOE staff understands that MSA revenue cannot be used to support the BOE’s MSA and related statutes enforcement and compliance activities. However, should another fund reimburse the BOE for MSA enforcement and compliance costs, such as the General Fund?

7. **Should the Tobacco Directory Law and related enforcement provisions be in the CTPTL?** RTC Section 30451 *requires* the BOE to enforce the provisions of the CTPTL. The Tobacco Directory Law was added to the CTPTL in 2003 pursuant to AB 71. Although the Tobacco Directory Law contains mostly non-tax provisions enforced by the Attorney General, it also includes provisions that appropriately relate to the CTPTL enforced by the BOE.

However, this bill proposes to expand information sharing in the Tobacco Directory Law, much of it unrelated to the BOE’s enforcement and administration of the CTPTL. Since the Tobacco Directory Law is primarily related to enforcement of the Model Statute, staff suggests the CTPTL be amended to place the Tobacco Directory Law in the Health and Safety Code (HSC) along with the Model Statute. In addition the non-tax related face-to-face sales provisions (RTC Section 30101.7)



should also join the Tobacco Directory in the HSC. The current BOE tax-related Tobacco Directory Law and face-to-face sale responsibilities should remain in the CTPTL.

In addition to maintaining only tax-related provisions within the CTPTL, the suggested transition to the HSC would more clearly define the BOE's and Attorney Generals role for enforcement and funding of the Model Statute and face-to-face sales. The cigarette and tobacco products tax funds, specifically, the General Fund, Breast Cancer Fund, Cigarette and Tobacco Products Surtax Fund (Proposition 99), and the California Children and Families Trust Fund (Proposition 10), provide funding under the CTPTL.

8. **Administrative start-up cost funding essential.** This bill likely will require the BOE to provide, in an unknown format, additional CTPTL information to the Attorney General beginning January 1, 2015 (Fiscal Year 2014-15). However, the BOE's 2014-15 budget does not include funding to reimburse the BOE for these additional information-sharing duties.

Typically, the BOE seeks administrative cost reimbursement through the Budget Change Proposal or deficiency letter process. However, reimbursement funding through this process is uncertain.

Constitutional and statutory provisions prohibit the BOE from using other special fund appropriations to support the cigarette and tobacco products tax program. Without an appropriation, it may be necessary for the BOE to divert 2014-15 cigarette and tobacco products funds planned for cigarette and tobacco products tax administration and collection to comply with the new information-sharing tasks. Such a diversion may result in a negative impact on the cigarette and tobacco products taxes program.

Accordingly, BOE staff suggests an appropriation to the BOE up to a determined dollar amount to cover the BOE's 2014-15 administrative costs.

## **COST ESTIMATE**

BOE staff anticipates administrative costs related to this bill; however, the extent of those costs is unknown until the Term Sheet states and PMs agree on the information type and form of transmission.

## **REVENUE ESTIMATE**

This bill does not impact cigarette and tobacco products tax revenues.

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Analysis prepared by:	Cindy Wilson	916-445-6036	04/02/14
Contact:	Michele Pielsticker	916-322-2376	
Is			1785ab021814Rcw.docx

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